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THE INDUSTRIAL OUTLOOK

This article was intended originally to be purely a forecast; but owing to some delay in preparation it has become in part an explanation of what has already occurred. Primarily, however, its purpose is to predict the course of industry.

Unless the problem of the industrial future is viewed from the standpoint of the entrepreneur it is difficult to arrive at a pessimistic conclusion. Most of the important long-time forces seem to point toward future growth and recuperation rather than toward industrial inactivity. We all ought to be richer in time of peace than in time of war. The labor and materials that have been utilized in war activities are becoming available now for the production of peace goods. Already industry has been freed from a host of restrictions imposed in the necessity of mobilizing the country's resources for the conduct of war. Day by day embargoes upon articles of export trade are being removed; the list of prohibited imports has been greatly reduced; shipping is increasing in quantity; building is being encouraged rather than discouraged by public authorities; industries formerly limited under the rationing policy of the War Industries Board to small amounts of labor and materials are being made free to utilize all they care to purchase. On the investment side, the Money Committee of the New York Exchange and the Capital Issues Committee of the Federal Reserve

Board have ceased to function. With such fetters removed and with a daily growing labor force at its disposal, why should not society be able to satisfy its wants in far larger volume than heretofore? Why should not business be even more brisk than in the days of war?

What is overlooked in these expressions of confidence is that in our present economic system the amount of production bears no necessary relation to society's potential labor force. Industrial activity, in greatest part at least, is directed by the private entrepreneur, with whom considerations of money profits are all important. Unless possibilities of profit appear, new industries will not be launched and old enterprises will be contracted. Unless industry is expanded employment will not be available for the returning soldiers, and these will be unable to bid for the products of other labor, or, in other words, to take part in the effective demand. The problem of the immediate future then resolves itself into the question of whether industrial and financial conditions are such as to convince the entrepreneur that money profits are imminent.

In many respects economic conditions do not appear to be such as to promise large rewards for enterprise. The entrepreneur remembers that, at the close of other wars, price levels usually have fallen. He cannot be at all accurate or confident, therefore, in predicting the future market for his products. At the same time production costs are now extremely high. Money wages of labor so far surpass pre-war levels that he does not believe that they can be maintained at present rates; but he may see no possibility of securing immediate wage reductions proportionate to the probable future decline in commodity prices. Raw materials have begun to decline, but in few lines to such an extent as to convince the entrepreneur that rock-bottom levels have been reached as yet. The entrepreneur may have no doubt as to the ultimate ability of industry to absorb the increasing number of available laborers; but what he is most interested in knowing now is whether the present is an opportune time to expand production: whether deflation is to be accomplished gradually, or in such a way as to bring values tumbling with a crash; whether we must have a serious depression before the economic revival can begin.

What are the doubtful factors in the situation, and what is the entrepreneur's attitude toward each of these? In preceding depressions the crisis has usually come at a time when the banks have had little surplus loaning power. Most crisis theories admit or imply that it is only the modern use of credit that renders possible the overwhelmingly sudden lapses in business confidence that we characterize as panics. What then is the money-market situation?

Here we find the business man somewhat confident. For two reasons he is wont to predict that money rates will be moderate. First of all, he knows that bank reserves are now fairly large; secondly, he believes that as prices decline the demand for bank credit will be less intense and that, with more moderate prices, not so large a quantity of liquid capital will be required to finance his transactions.

The most important of the bank reserves now are those held by the reserve banks. During the war these have become the reservoirs into which has flowed a large proportion of the country's money supply. At the present time the reserve banks hold legal tender money to an amount slightly exceeding 50 per cent of the total of their note and deposit liabilities. Since the minimum required by law is a 40 per cent gold reserve for notes and 35 per cent lawful money reserve for deposit credits, there is at the present time a fairly large surplus reserve in the vaults of the reserve banks.

There are several reasons, however, for fearing that we are now more optimistic in calculating the ease which these surplus reserves will bring the loan market than we shall be in the near future. In the first place, we have not as yet completed our program for raising money for war requirements. It is true that the next bond issue is not likely to expand bank credits to any extreme degree; for in large part this issue will be necessary merely to make reimbursement to the banks for funds already loaned the government through the medium of short-term interim certificates. In so far as the banks do subscribe to the next issue, they will to a large extent merely receive a new form of a government promise for the maturing interim certificate. But this will not be true of future bond issues, which must be floated, even if not offered directly to

the public. To the extent that people have come to regard the war crisis as over and have ceased saving, these issues must be absorbed by the banks and financial institutions and will thus work in the direction of increased bank credits.

Furthermore, it is not likely that the Reserve Board will view with equanimity any expansion of credit that causes reserves to approach much closer to the minimum set by law. While the writer believes that the reserve system's rediscount policy has been unduly liberal in the past, there are now signs that the administration is becoming more conservative. For in the past year, despite enormous gold accumulations, the board has witnessed a reduction of 12 or 13 per cent in its reserve percentages. Another year of such rapid expansion of bank credit would have left little margin over the legal minimum.

It cannot be emphasized too strongly that these reserves are ultimate reserves. They constitute the foundation which supports the weight of a large part of the country's credit structure. They must be guarded most carefully. The minimum figures set by law may not prove ample. In normal times it has not been at all uncommon for the reserve of the Bank of England, for which law sets no minimum, to exceed 40 per cent. And the Bank of France's reserves have often surpassed 60 per cent.

There is a considerable amount of gold in the country not in the vaults of the reserve banks, and some means may be found to gather in a considerable portion of it. In the past we have grown accustomed to witnessing almost weekly increases in the reserve system's gold holdings. Owing to the fact that such gold permits the several-fold extension of credits to the member banks, which credits in turn may be counted as a part of the reserves of member banks, any concentration of gold in the reserve system's reservoirs increases many fold the possibilities of credit extension to the public. But we must not overlook the fact that there are at least possibilities of a future drain upon this gold, and that any decrease in the gold holdings of the reserve system will result in an equally great limitation upon our ability to extend bank credit. This drain may be either an external or an internal drain. Let us consider first the possibilities of a foreign drain upon our gold.

During the war the embargo upon gold has prevented us from squaring our indebtednesses to many of the neutral countries by shipments of metal. As a consequence such countries as Argentina and Spain and the northern Scandinavians have acquired such large quantities of dollar credits that exchange rates have moved against us, in some substances, to points far below the normal gold par. As a permanent situation a depreciated dollar exchange cannot be tolerated, both because of its adverse effect on our future position in international trade and because of the immediate losses to our importers and exporters. In the past we have witnessed many difficulties in the endeavors to stabilize exchange by requests for foreign credits. In the immediate future shipments of goods are not likely to be in such quantities as to restore the dollar to its normal gold par in these countries. The permanent solution may quite conceivably demand heavy shipments of gold.

Any interior drain upon the reserve system's money supply, if it occurs, will take the form undoubtedly of redemption of the Federal Reserve notes. These have now been issued to a quantity approximating two and a half billions of dollars. Member banks have been induced to accept them because for counter money purposes they are as good a currency as any. But they cannot be counted as part of the member bank's legal reserve. In no respect will the holder consider them a currency superior to gold certificates. During the war appeals to patriotism may have been important in inducing the member banks to accept them. While the writer does not deem it probable, it is quite conceivable that the situation may arise in which the holders of these notes may demand their redemption in extremely larger quantities. Such possibilities, at least, must be guarded against.[1]

As to the assertion that future demands for credit will be less intense because of lowering prices, the writer is willing to express partial agreement. But falling prices, to the extent of their decline, will necessitate new loans. The weakened market will bring to many great reluctance to dispose of large quantities of their products, and there will be created in this way demands upon the

[1] Cf. H. L. Reed, "Credit Expansion under the Federal Reserve," *American Economic Review*, June, 1918, pp. 270–82.

banks to carry such previous borrowers over the period of difficulty. In other words, the number of renewals will tend to become larger.

Predictions that money rates will become extremely low in the immediate future do not, therefore, appear to be justified. It is unfortunate that this is the case. The credit policy of the Federal Reserve Board will be condemned no doubt by most future historians. Inflation of credit during the war, by raising prices and thence entrepreneurs' profits, rendered it all the more difficult to transfer labor and materials to war industries. So far as reliance was to be placed upon financial measures, restriction of credit to peace industries would seem to have been the desirable method. But as it was, in order to obtain labor and materials for the shipyards and munitions plants, the already inflated rates in non-essential industries had to be exceeded.

The time for credit expansion would seem to be now, after hostilities are over, rather than in the war period. If our gold had been husbanded carefully we could extend credits now most liberally to foreign countries and thus hasten the process of reconstruction abroad as well as build up new markets in oriental and South American countries. With plenty of gold New York could make the attempt of London to regain its former pre-eminent position in international finance, if not hopeless, at least extremely difficult for years to come. But as it is, foreign credits must now be somewhat restricted because prices have been adjusted at home to higher levels.[1]

From the standpoint also of domestic industry we could gain by inflation now. The tonic stimulus of high commodity prices and high money wages are well known. But the time to administer this tonic is when it is desired to expand rather than to contract the operations of peace industries. We need easy money rates now to secure the speedy return of labor into industry. We suffered by having easy rates when we wanted to get labor out of peace industries.

Professor Moulton has recently developed some conclusions in regard to the formation of capital or indirect goods from which one might infer the need for inflation now, rather than during the period

[1] *Op. cit.*, pp. 281–82.

of hostilities.[1] He states that the production of indirect goods takes place most largely in periods of heavy rather than in periods of light consumption of direct goods. Lessened consumption of direct goods may destroy the profit possibilities in the production of the indirect. It is not from thrift or individual saving that the bulk of the investment funds have been obtained in periods of rapid construction of equipment goods. In large part such funds have represented the expanding credit grants of commercial banks. The labor for the production of the indirect goods must not be considered so much a subtraction as a virtual addition to that utilized in the production of direct goods resulting from less unemployment and more enthusiasm on the part of both the entrepreneur and the laborer.

At the present time inflation would furnish a means for obtaining the funds for the production of indirect goods, and the necessity of increasing our production of indirect goods is relatively much greater now than in most periods prior to the outbreak of the war. The sacrifices of war have of course lessened our production of both direct and indirect goods for peace purposes. But the lessened demand for many of the perishable goods that furnish direct enjoyment is water that has passed under the mill; it will never affect the future course of production. This cannot be said in such large degree of durable equipment goods. Buildings not repaired, roads not constructed, machinery allowed to depreciate, represent increased demands on future production. With larger bank reserves the liquid capital necessary for the production of these durable productive agents could be obtained and rising prices for consumption goods would stimulate entrepreneurial seizure of opportunities for the creation of the indirect.

The sudden termination of hostilities left us, however, in a stronger reserve position than we had any right to anticipate, and accordingly the mistakes of our financial administration will not bear so heavily upon us in the reconstruction period. With conservative management present bank reserves should prove sufficient to prevent any serious lapse of business confidence so far as liquid

[1] Cf. Harold G. Moulton, "Commercial Banking and Capital Formation, IV," *Journal of Political Economy*, November, 1918, pp. 869–864.

capital is concerned. But money rates will be higher and reconstruction will be more difficult than need have been the case.

With organized labor insisting that there shall be no reductions in money wages even at a time of falling commodity prices, and with the constant return of many soldiers from the field and camp and the release of many others from the munitions factories, the seriousness of the labor situation cannot be overestimated. But the fact that labor officials are insisting so strenuously that the old standards shall be maintained shows at least that in the main the general advance in money wages is at an end. And in many cases virtual reductions in money wages may be accomplished more easily than is often surmised. In many industries the apparently fabulous wages have depended largely upon the high rates for overtime. These last hours, both because of the fatigue of the laborer and the extra rates, have been the expensive hours to the employer. With less overtime employment there may be an actual if not nominal reduction in wage outlays, and each dollar expended should represent greater productivity than in the past, even though hourly rates are not reduced.

Now and then we even hear of voluntary acceptances of wage reductions by the laborers themselves. Such cases, however, have been rare. They have been confined chiefly to industries where the employees have had the utmost confidence in the fairness of the employer, and where the employer could demonstrate easily, possibly because of definite contracts tendered him, his inability to offer employment at the old rates.

There is at least one respect in which the present situation is more hopeful than in most previous periods when expanding business has bred the forces of depression. On the eve of the depression we have found usually that activity in industry has created not merely higher wages for labor, but has also called into steady employment the most inefficient of the workers. Further expansion, in so far as it depended upon labor considerations, would be costly both from the standpoint of wage outlays and results achieved. This has served to check further industrial activity. But, at the present time, the situation may be far different. Many of the returning soldiers represent the most efficient part of our

labor force. At least from the standpoint of endurance and physical strength they represent a selected class. Habits of discipline acquired in the service may stand them in good stead. It is with such as these that the worker who has remained in peace industry must compete, and if an expansion in industry can be engineered the employer will not be so handicapped by the necessity of offering the high wages for incompetent labor. The worker may soon learn that inefficiency cannot be tolerated, that jobs are not overplentiful. Many of the evils evidenced by the figures of the exceedingly rapid labor turnovers of the past year should at least be mitigated. High money wages, even when prices fall, are not impossible if labor works on a high plane of efficiency.

Offsetting these considerations, however, are the possibilities that the life of the soldier has created in him an unwillingness to do steady work in monotonous tasks and he may not find it easy to find employment in the position for which he is best fitted and trained and which he was forced to abandon by the call to arms.

The writer does not wish, of course, to record any lack of sympathy with the aims of labor. But it must be recognized that under our present system the problem of speedy and effective reconstruction depends primarily upon the attitude of the private entrepreneur. It may or may not be fortunate that industry is thus dominated. But we are forced to make predictions of the immediate future of industry from the standpoint of its present control.

Will the manufacturing entrepreneur regard the present costs of raw materials as forbidding? There is no doubt that the high prices of materials and the prospects of future drops are creating grave uncertainty at the present time. Efforts to stabilize such prices, to get quickly to rock-bottom levels, have thus far proven unsuccessful. Shortly after the signing of the armistice terms there was a sharp decline in the prices of many such materials and the producers announced that the lowered quotations were given to remove uncertainty or, in other words, to get quickly to the lowest possible levels. To convince the manufacturers that there would be no lower figures many producers announced that the reduced prices were minimum prices; that rather than sell below these they would suspend production. In the case of the monopolized

industries it is conceivable that such control of production might have been realized. But later events tended to disprove many of these assertions. In many lines the prices at first announced as the irreducible minima have been superseded by still lower quotations. We hear from time to time that certain government measures are being contemplated in the hope of stabilizing immediately the prices of the more important materials of production; but it does not as yet appear that the governmental machinery for realizing these purposes can be adequate. For some months, at least, uncertainty must continue to prevail regarding such prices.

What now about the markets for the entrepreneur's products? Are they in such a condition as soon to call forth a quickening of business activity? Let us consider the domestic markets first, because domestic sales greatly exceed the volume of foreign transactions and because in domestic trade the buyer and seller, the consumer and producer, both reside in this country.

In many ways business can point to the domestic market situation with a feeling of optimism. During the war, either through motives of patriotism or through governmental compulsion, consumption of many products has been restricted and reserve stocks seriously depleted. Shoes and clothing have been worn longer, the manufacture of pleasure automobiles has been limited because of the army's need for trucks and tanks, public building has been almost suspended except when necessary for war purposes, road-building plans have been abandoned, and even the production of farm tractors and agricultural machinery has been curtailed. In most of the metal-producing industries the war plant has been given the preference. In contemplating these markets, therefore, the entrepreneur becomes enthusiastic. For here are *new* markets, new demands to be satisfied.

This enthusiasm would no doubt be justified if the entrepreneur could point to a scarcity in his product at a time when there is an abundance of other goods. But is it a real occasion for rejoicing to find so many stocks depleted? Is not the business man reasoning from the particular to the general in an incorrect way? Is it not true that, while it may be a good thing for a single entrepreneur

to find a scarcity in his line, it would not be well to find a scarcity in all lines, for general scarcity means poverty and an impairment of our common well-being?

Nevertheless, the writer feels that the business man's conclusions are not altogether incorrect. Within certain limits his optimism appears to be justified. This belief may be substantiated on the following grounds:

1. The demand for goods which have been commonly and customarily consumed may be gauged much more accurately by the entrepreneur than the demand for quality goods which depend largely upon style and taste.

2. It is better that, for the present, production should be devoted largely to goods the demand for which can be predicted most accurately.

3. It may be better to have continued production and a full use of our labor resources from a starting-point of scarcity than interrupted production and partial unemployment beginning with a period of relative plenty.

4. Particularly from the standpoint of the psychology of the worker, an adequate system of distribution which follows full employment soon reacts upon production.

The basis for the first reason is, I believe, obvious. The elemental and more essential wants may be much more accurately appraised than the more refined wants, wants which appeal largely to personal tastes. Past experience has taught much regarding the extent of the market for necessaries, regarding methods of marketing such goods, regarding the technique of their production. In the creation of the more staple goods mistakes are not nearly so probable. But new styles and superfine fashions are fleeting and seductive, refined amusements may not please, the people may lose interest in the higher goods. If such mistakes are made, production is greatly disturbed, labor violently upturned, and poverty and want follow even at a time when the warehouses are stocked with finished goods and factories glutted with partly worked raw materials. A steady demand and full employment are necessary to insure a continuous flow of society's products into the hands of the people.

If, on the other hand, there are known to be deficits in the more elemental wants, industry is not bewildered by the choice of opportunities, the investor not confused by the appraisement of so many unknowns, and the labor and capital resources of the country may be completely and steadily utilized. Steady employment of labor prevents any serious slack in production and *gradually* new demands and new industries are created. There will not at least be the spectacle of vast wealth in the factories, on the machines half completed, while at the same time no adequate means can be found of getting the most essential goods into the hands of the masses. In a short time the wealth of the people through the more complete utilization of their productive resources may far surpass what it would have been had there been an initial point of plenty but continued maladjustment of production.

A people without steady employment soon develop habits of thought, habits of living, habits of work absolutely inconsistent with efficient production. Undoubtedly the worst possible situation now would be that in which the unemployed from the army and the munitions plants should find themselves unable to obtain the necessaries of life at a time when production is largely devoted to the satisfaction of relatively superfluous wants. The problem of preventing violent labor disturbances will be sufficiently difficult without this apparent proof of the injustice and planlessness of the present economic system.

The writer believes, therefore, that the problem must be viewed primarily from the standpoint of the entrepreneur, that in a time when a great redistribution of the labor force is inevitable we must regard as favorable all factors which render more easy the choice of opportunities. If this is true the present scarcity in so many products of common consumption is, within certain limits at least, an encouraging rather than a discouraging factor. We should regard the annual production of society as of greater importance than the inherited accumulations of the past.

Nevertheless, it is easy to exaggerate the effects of past economy. So far as the objects of such abstinence were perishable products, future demands will be to a large extent uninfluenced. Unsatis-

fied desires of the past may never affect future prices; gorging today will not relieve the hunger of yesterday; and past economy may have induced habits of thrift, habits of saving, that will not soon call forth the full measure of our productive energies.

To a marked extent the economies of the war period have been in fields controlled by public authorities, such as work on the roads, on public buildings, on various utilities. It would seem as if these economies soon must result in large demands for labor. But in peace times such expenditures are controlled by municipalities and states to a greater extent than by the federal government. The present state of the federal government's finances, furthermore, will render difficult the development of any comprehensive national policy for solving the unemployment difficulty. States and cities will be discouraged in quite the same manner as private enterprises by the prevailing high costs of labor and materials. It may be that the various cities will take pride in preventing unemployment within their jurisdictions, and regard such unemployment as their own responsibility. But even at this early date there are evidences that municipalities will find it most convenient to thrust responsibility upon some other body. Daily we read that the cause of unemployment in this or that city was the failure of soldiers to return to their places of original induction. Some other city, therefore, is responsible for the unemployment of these men. Everywhere there will be great reluctance to float new loans or to increase taxation. Much will be heard of the high burden of present taxation. It will be forgotten that taxes taken out of the pockets of one increase the revenues of another.

As regards foreign markets even the most pessimistic of present predictions may not serve to prevent disappointment in the near future. There is of course no question as to the need for our products by the belligerent countries of Europe to rehabilitate their ravaged districts and to repair run-down factories and machinery. But for the present they will limit their demands probably to what they will regard as absolutely indispensable for immediate needs. These countries, unlike our own, have not recently witnessed any such remodeling of their banking systems as to leave

their money markets in an easy situation. In Europe high prices and strained credit have gone hand in hand. The Bank of England's reserve has fallen during the war from more than 50 to less than 20 per cent. Inflation in other European belligerent nations has proceeded to even greater degrees.

But it is argued that if the war had continued these countries would not have hesitated to expand their credits still further. Why, then, should they now cease buying in view of the necessity for speedy reconstruction? The answer is that all of them have seriously endangered the gold bases of their currencies and credit and have undoubtedly resolved to terminate this policy immediately upon the arrival of peace. The Bank of England can no longer be said to control the foreign exchanges. The virtual prohibition on gold exports has placed it at the mercy of foreign loans to stabilize the exchange. Sterling exchange fell well toward $4.50 before it was pegged at $4.76 by credits obtained here. Even at $4.76 the pound sterling is far below its normal gold par.

This is not a welcome state of affairs for a city that has so prided itself on being the world's financial center and has realized such large profits because of the gold stability of its credits. Recently a parliamentary commission on foreign exchange has stated that the Bank of England must undertake immediately the task of restoring the gold basis of sterling credits. It pointed out that until this was accomplished London could not hope to regain its former position as holder of the world's purse strings. England, therefore, must develop its export trade or curtail its import trade as soon as possible. In line with this injunction it is not surprising that Great Britain has made recent use of the embargo to restrict imports. Similar considerations hold for the other European belligerents with whom the losses due to the current rates of foreign exchanges are even greater.

The European belligerent countries might not be so reluctant to buy from us if they could do so on the basis of long-time credits. For the time being greatly enlarged short-time credits are out of the question. But with long-time credit they might reason that they could purchase raw materials and machinery here, thus increasing

their own ability to export, and have ample time in which to make repayment.

But who is to extend such credits? During the war our government has placed part of the proceeds of taxation and bond issues to the credit of our allies. This method may become unavailable to any great degree in the future. If so, some method must be devised for obtaining such credits from our investing or banking public. During the war we have become somewhat acquainted with the issues of European governmental bodies, and for such securities a good market here may soon be developed. But as for the stocks and bonds of foreign industrial concerns not so much can be said. As yet our investing public is not sufficiently acquainted with European industrial issues.

Since the establishment of the Federal Reserve System, serious efforts have been made by the financial interests of this country to develop trade with South American countries. Only recently the National City Bank has announced the establishment of several additional branches in these countries. Literature emanating from New York City banks shows that efforts to acquire markets in these countries are being made with redoubled energy. But for the immediate future not too much can be expected. We were only beginning to develop these markets on a large scale when we became involved in war and our efforts in that direction were necessarily interrupted.

Even though on a somewhat restricted scale such welcome surprises as we find in foreign trade are most likely to be with the non-belligerent countries of Europe, Spain, Switzerland, and the Scandinavians. These countries find themselves in a favorable money position. During the war they have expanded their foreign trade industries and the exchanges have been constantly in their favor. They have accumulated such large dollar credits that they need not have the same fears of buying on the short-time payment plan as have the European belligerents.[1]

All in all, the immediate future seems very dubious. There is grave uncertainty as to labor conditions, as to markets, as to future

[1] Cf. H. L. Reed, "Senator Owen's Proposal to Stabilize Foreign Exchange Rates," *American Economic Review*, September, 1918, pp. 661–73.

prices. During the war industry has been intoxicated with high prices and easy credits. It seems probable that in many important industries prices and wages must fall still further before the industrial recovery can begin. Business has not yet settled to a normal and stable basis.

In view of our fairly large bank reserves there will be no panic. Were it not for these the present situation would be alarming. That the surplus reserves have not vanished, however, is due to no merit of our financial administration. With another year of hostilities they would have closely approached the minimum set by law.

It is worth while to take note of every factor which points toward financial security these coming months. One such factor is the present state of the security markets. On the basis of present earnings prices of many stocks are now so moderate as to indicate that the possibilities of future declines in dividends have been generously discounted. In this respect the present situation bears some analogy to that existing at the close of the Civil War. Then so many were convinced that a panic was inevitable that their consequent caution prevented such an outcome.

What remedies would the present situation seem to suggest in order to avoid the evils of unemployment? Many measures of small detail can and will be employed for the purpose of preventing the distress of those without work. But a sudden and complete cure does not lie within present reach. The only adequate preparation for reconstruction was a control of credit in the war months which would have rendered the present a favorable rather than an unfavorable time for industrial expansion. Such control we have not had. If during these coming months large numbers of unemployed walk the streets of our cities, if strikes and labor troubles abound, if Bolshevism stalks in violent guise, we have only ourselves—or, more precisely, those who have dominated our financial policy—to blame.

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